

Franchise Tax Board**ANALYSIS OF AMENDED BILL**Author: Garcia Analyst: Marion Mann DeJong Bill Number: AB 363Related Bills: See Legislative History Telephone: 845-6979 Amended Date: May 7, 2003Attorney: Patrick Kusiak Sponsor: _____**SUBJECT:** Employer Provided Health Coverage Credit/Farmworkers**SUMMARY**

This bill would create an allocated credit for employers who provide health care coverage for their agricultural employees and those employees' dependents.

SUMMARY OF AMENDMENTS

The May 7, 2003, amendments deleted the provisions of the bill as introduced and inserted the provisions discussed in this analysis.

PURPOSE OF THE BILL

According to the author, the purpose of this bill is to expand agricultural employees' access to health insurance while retaining the sales tax incentives for farmers.

EFFECTIVE/OPERATIVE DATE

As a tax levy, this bill would become effective immediately upon enactment. However, the bill specifies that it would apply to taxable years beginning on or after January 1, 2004.

POSITION

Pending.

Summary of Suggested Amendments

Amendments are needed to resolve the department's concerns regarding the allocation and penalty and to provide an appropriation for the credit. See "Implementation Considerations" below. Department staff is available to assist the author with amendments. In addition, technical amendments are provided. See "Technical Considerations" below.

Board Position:

<input type="checkbox"/> S	<input type="checkbox"/> NA	<input type="checkbox"/> NP
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<input type="checkbox"/> N	<input type="checkbox"/> OUA	<input checked="" type="checkbox"/> PENDING

Department Director

Date

Gerald H. Goldberg

5/23/03

ANALYSIS

FEDERAL/STATE LAW

Current federal and state laws generally allow taxpayers engaged in a trade or business to deduct all expenses that are considered ordinary and necessary in conducting that trade or business. For example, an employer would be allowed a deduction for the cost of health care coverage provided to employees.

Existing federal and state laws provide various tax credits designed to provide tax relief for taxpayers who incur certain expenses (e.g., child adoption) or to influence behavior, including business practices and decisions (e.g., research credits or economic development area hiring credits). These credits generally are designed to provide incentives for taxpayers to perform various actions or activities that they may not otherwise undertake.

Currently, there are no federal or state credits for employer-provided health care coverage. Prior state law would have provided a small-employer health coverage tax credit (SB 2260, Stats. 1988, Ch. 1521). However, the credit was repealed before becoming operative.

THIS BILL

This bill would create an allocated credit for certain farm worker employers. The aggregate amount of tax credits available for 2004 would be \$80 million. This amount would be increased annually for inflation by the change in the California Consumer Price Index.

To be eligible for the credit, the taxpayer must either employ agricultural employees directly or be a labor contractor that employs agricultural employees for use by farmers and:

- Provides those employees and their dependents with health care coverage and pays at least 80% of the cost of that coverage.
- Applies to the Employment Development Department (EDD) for the credit by January 31, following the close of the taxable year for which the credit is claimed.

The health care coverage must be equivalent to either of the following:

- A health care service plan under the Knox-Keene Health Care Service Plan Act of 1975.
- A plan that would qualify under the Employee Retirement Income Security Act of 1974 and provides substantially the same minimum benefits as required under the Knox-Keene Health Care Service Plan Act of 1975.

EDD would do all of the following:

- Determine the amount of allocated credit for each taxpayer who applied by multiplying the aggregate credit amount (\$80 million for 2004) by a ratio of the amount the taxpayer paid for health care coverage for agricultural employees and their dependents to the total amount all taxpayers who applied for the credit paid for health care coverage.
- Provide written notification of the credit amount to each taxpayer by February 28th of each calendar year.
- Provide an annual list to the Franchise Tax Board (FTB), preferably on a computer readable form.
- Notify all known qualified taxpayers regarding the availability of the credit.
- Send each known qualified taxpayer an application to participate in the credit allocation.
- Promulgate rules or regulations as deemed necessary to implement its duties under this bill.

Unused credit amounts could be carried forward for six years. Fraudulent credit claims would be punishable by a criminal penalty of up to one year in jail and a fine of up to \$60,000.

IMPLEMENTATION CONSIDERATIONS

Since EDD would allocate the credit among taxpayers, implementation of the credit would not significantly impact the department. Implementing this bill would require some changes to existing tax forms and instructions and information systems, which could be accomplished during the normal annual update. However department staff has identified the following concerns regarding the credit allocation:

- The bill does not provide an appropriation for the amount to be allocated.
- Currently the allocation is based upon a taxable year, but the specifics of the allocation assume that all taxable years are calendar years. Taxable years are 12-month periods, but are not necessarily the same as a calendar year. For example, for the calendar year 2004, the earliest taxable year would be January 1, 2004, to December 31, 2004; the latest taxable year would be December 1, 2004, to November 30, 2005. Thus, the allocation period would be for 23 months not 12 months.

Department staff has also identified concerns regarding the criminal penalty for fraudulent credit claims. Since this penalty is based upon the criminal penalty for tax evasion administered by FTB, it appears that FTB is to assess the penalty. However, EDD would have the information required for determining if a penalty is warranted. Amendments are needed to clarify how the penalty is to be implemented and which department is responsible for assessing the penalty and resolving any disputes arising from its assessment.

TECHNICAL CONSIDERATIONS

Amendments 1 and 5 would revise an awkward sentence.

Amendments 2 and 6 would clarify that a reference to "the department" is referring to EDD rather than FTB.

Amendments 3, 4, 7, and 8 would replace the term "qualified taxpayer" with "employers of agricultural employees." Since qualified taxpayers are those that have already applied to EDD for the credit, the use of the term does not work in this context.

LEGISLATIVE HISTORY

AB 923 (Firebaugh, Chavez, and Wesson 2003/2004) would create a tax credit basically the same as the credit created by this bill. The main difference is the credit in AB 923 would be allocated from revenue raised by repealing certain sales tax exemptions. AB 923 is in the Assembly Third Reading File.

AB 293 (Daucher, 2003/2004) would allow full-time employees of small businesses to contribute up to five hours a week of paid, tax-free, overtime towards the employees' share of health care coverage costs. AB 293 is in the Assembly Committee on Health.

AB 790 (Maldonado, 2001/2002), 2208 (Frusetta, 1999/2000), and AB 1172 (Frusetta, 1999/2000) would have created an employer tax credit for providing health care or health insurance to farmworker employees. AB 790 and AB 1172 failed passage out of the house of origin before the constitutional deadline for two-year bills. AB 2208 failed to pass out of the Assembly Appropriations Committee.

OTHER STATES' INFORMATION

The laws of *Florida, Illinois, Massachusetts, Michigan, Minnesota, and New York* were reviewed because of similarities to California's economy, business entity types, and tax laws. None of these states provide a credit comparable to the credit allowed by this bill.

FISCAL IMPACT

This bill would not significantly impact the department's costs.

ECONOMIC IMPACT

Revenue Discussion

The revenue impact of this bill, under the assumptions discussed below, is estimated to be as follows:

Revenue Impact of AB 363 as Amended May 7, 2003 Tax Years Beginning After January 1, 2004 Enactment Assumed After June 30, 2003 \$ Millions				
	2004-05	2005-06	2006-07	2007-08
Revenue Impact	-\$50	-\$65	-\$65	-\$70

The estimate assumes that most qualified farmers would apply to EDD on a timely basis for the allocated credits. This estimate does not account for changes in employment, personal income, or gross state product that could result from this bill.

Revenue Discussion

As far as the income-tax revenue loss is concerned, this bill is identical to AB 923 (Firebaugh, Chavez, and Wesson 2003/2004) and a similar analysis applies. It is assumed that only 70% of the taxpayers would have sufficient tax liability to use the credits. The first year impact considers the fact that some fiscal-year taxpayers would not be able to use the full amount of credit until after June 30, 2005. The unused credits would be carried forward to the succeeding six years.

The first year impact was arrived at as follows.

Aggregate amount of the allocated credits	\$80,000,000
Times the percent of positive income taxpayers	<u>× 70%</u>
Equals the qualified credit amount	\$56,000,000
Minus the amount due to late fiscal filers	<u>-\$6,000,000</u>
Equals the first-year impact	\$50,000,000

ARGUMENTS/POLICY CONCERNS

- This bill does not contain a sunset date. Sunset dates generally are provided to allow periodic review of credits by the Legislature.
- Conflicting tax policies come into play whenever a credit is provided for an item that is already deductible as a business expense. Providing both a credit and allowing the full amount to be deducted would provide a double benefit for that cost. On the other hand, making an adjustment to deny or reduce the deduction in order to eliminate the double benefit creates a difference between state and federal taxable income, which is contrary to the state's general federal conformity policy.

LEGISLATIVE STAFF CONTACT

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FRANCHISE TAX BOARD'S
PROPOSED AMENDMENTS TO AB 363
As Amended May 7, 2003

AMENDMENT 1

On page 3, strikeout lines 3 through 5, inclusive and insert:

(A) Pays or incurs at least 80 percent of the cost of qualified health care coverage for those employees and their dependents.

AMENDMENT 2

On page 3, line 7, delete "the department," and insert:

that department,

AMENDMENT 3

On page 4, line 1, strikeout "qualified taxpayers" and insert:

employers of agricultural employees

AMENDMENT 4

On page 4, line 3, strikeout "qualified taxpayers" and insert:

employers of agricultural employees

AMENDMENT 5

On page 5, strikeout lines 7 through 9, inclusive and insert:

(A) Pays or incurs at least 80 percent of the cost of qualified health care coverage for those employees and their dependents.

AMENDMENT 6

On page 5, line 11, delete "the department," and insert:

that department,

AMENDMENT 7

On page 6, line 6, strikeout "qualified taxpayers" and insert:
employers of agricultural employees

AMENDMENT 4

On page 6, line 8, strikeout "qualified taxpayers" and insert:
employers of agricultural employees